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Before the
Federal Communications Commission
Washington, D.C. 20554

AUG 21 2001

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

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Developing a Unified Inter-carrier
Compensation Regime

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CC Docket No. 01-92

**COMMENTS
OF THE**

UNITED STATES TELECOM ASSOCIATION

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August 21, 2001

No. of Copies rec'd 014
DATE 08/21/01

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SUMMARY

The FCC should create policies for the future that will provide positive incentives for investment in network infrastructures, diminish outmoded regulatory structures and accommodate technological and market forces. Regulatory arbitrage opportunities and old regulatory distinctions that no longer make sense should be eliminated. The FCC must recognize the new technology platforms that are growing rapidly without the arbitrary restrictions specifying geographic boundaries, services and pricing structures. These platforms are delivering bundles of digital services seamlessly, including voice, data, Internet access, video, music and e-commerce. Changing the methods, revenue flows and cost recovery responsibilities among carriers, services and locations in this environment will have widespread consequences, many of which will be positive, although major and unwelcome dislocations may occur due to the sheer size and reach of the financial impact of the change. The FCC must establish equitable transition mechanisms that provide a clear signal of its objectives as well as sufficient notice of the changes that it intends to implement so that all service providers, manufacturers, investors, employees and customers know what to expect and have sufficient opportunity to prepare. For some carriers, the existence of current transition mechanisms may lessen the urgency to move to bill and keep, at least until the transition mechanisms are completed. Other carriers view these transition mechanisms as insufficient to meet their needs.

Regulatory arbitrage, technology and market demands raise concerns as to how important issues will be addressed under a bill and keep compensation arrangement. Given that cost recovery responsibilities would be shifted among carriers, customers, services and locations, appropriate recovery of costs is critical for carriers to maintain and increase infrastructure investment. Carriers that rely on revenues received from current compensation arrangements

that could be displaced must have an equal opportunity to recover costs from alternate sources. End user pricing flexibility will be required. In areas where end user recovery could result in prices that are not affordable and reasonably comparable, universal service support will be required. While competition is likely to be even more intense in the future, competition and technology do not necessarily develop in the same manner and at the same time in all areas. While market forces should drive deployment, consumers in all areas should have access to advanced telecommunications capability in a reasonable and timely fashion. Timing of any change in compensation arrangements is critical to ensure that carriers maintain revenues necessary to serve customers and attract new ones and to allow time to change current network structures as necessary. Finally, the efficiency gains from changing the current compensation arrangements will be diluted to the extent that current regulatory handicapping and platform discrimination is not stripped everywhere from the FCC's rules.

To address these issues, **USTA** recommends the adoption of the following objectives to guide FCC policies: minimize regulatory intervention, coordinate state and federal policies, ensure competitive neutrality, ensure technological neutrality, maintain universal service, provide incentives for investment and innovation and ensure quality of service.

In its comments, **USTA** discusses some of the pros and cons of bill and keep. Bill and keep provides greater opportunities to achieve economic efficiency than CPNP and will encourage reliance on market-oriented solutions rather than regulation. There also may be harms associated with bill and keep, particularly if current access revenue streams are displaced and end user recovery is required, regarding the affordability of rates, the ability to maintain end user rates that are reasonably comparable between urban and rural areas and the incentives to invest in the infrastructures. **USTA** provides data showing the impact on end users if intrastate and

interstate switched access is recovered from end users instead of carriers. The current universal service mechanisms are not designed to accommodate these impacts, both in terms of the sufficiency of support and in terms of maintaining equitable contributions. The BASICS bill and keep proposal would be difficult to implement and administer and would require regulatory intervention. Using the central office as the POI as proposed in COBAK raises many concerns since carriers may locate their switches great distances from where the call actually terminates. Originating carriers could incur substantial costs to transport traffic to a terminating carrier.

USTA describes a framework for a possible bill and keep policy. That framework includes the following conditions that must exist: transitional equity, universal service, pricing flexibility, application to all carriers, networks and technologies, application to both the intrastate and interstate jurisdiction and the development of a reasonable bill and keep process. The policy must reflect a preference for negotiation and a reduced reliance on regulation. Rebalancing of current price structures and development of appropriate universal service mechanisms must accompany bill and keep. There must be a geographic limit on the network access provider's obligation to reach the POI. Network access providers with transport obligations should be free to build their own facilities or lease facilities from a wholesale provider or from the called party's network access provider. But, network access providers should not be required to provide transiting services or otherwise act as a wholesale provider without reasonable compensation. Quality of service issues may have to be determined to define a network provider's responsibility to carry traffic and to define reasonable interconnection parameters. Specific processes will have to be initiated to address the following: simultaneous implementation at the state and federal level, operational issues, timing and universal service.

The proposals to change the CPNP regime contained in the NPRM should be rejected. TELRIC is not appropriate to set access charge or reciprocal compensation rate levels. The use of TELRIC for access charges and reciprocal compensation will not ensure that LECs fully recover the costs of providing service and would require the FCC to retain all of the regulatory cost identification and allocation rules that are so inefficient and extend them to LECs previously not subject to such rules. Likewise, using short run incremental costs would exacerbate current pricing anomalies and arbitrage opportunities because it has the potential to create significant variations in costs that will require increased regulatory oversight to track. New rate structures should not be mandated and carriers should have the flexibility to use a capacity-based or other rate structure if reasonable.

Finally, the current use of virtual NXX codes should not be permitted because it creates a cost recovery anomaly. The use of a virtual NXX means that the call is rated as local even though the customer is not physically located in the exchange to which the NXX is assigned or does not subscribe to the use of facilities located in that exchange. Thus, the customer avoids paying toll charges, the carrier using the virtual NXX avoids transport or access charges and the originating LEC must pay reciprocal compensation. Virtual NXX also misuses scarce numbering resources and has the effect of changing the local calling area of the originating LEC. This misuse of numbering resources to provide service to customers who do not physically maintain a presence in the rate center should not be permitted under CPNP unless the carrier using the virtual NXX pays for the transport from the rate center to the customer as well as any other appropriate compensation and the integrity of numbering resources is preserved.

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**COMMENTS
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I. INTRODUCTION AND SUMMARY

The Federal Communications Commission (FCC) has initiated a fundamental reexamination of all currently regulated forms of intercarrier compensation with the intention of testing the concept of a unified system for the flows of payments among telecommunications carriers that result from the interconnection of telecommunications networks.¹ The NPRM also requests comments specifically on bill and keep as the new unified system. Any attempt to manage the evolution of the communications industry and to create policies that will make sense in the future poses a daunting challenge. Change is inevitable, yet the stakes are high. The choices made by regulators, service providers, manufacturers, investors, employees and consumers have significant ramifications, particularly for an industry undergoing such rapid evolution. The pace of change and the speed of the technological and market forces propelling it may well exceed the ability of many participants to anticipate, comprehend and react to the choices that are made. The status quo is impossible to preserve. Even in the current period of market uncertainty with the financial community closely scrutinizing investment in telecommunications, the FCC needs to make decisions regarding the future that will provide

¹ Developing a Unified Inter-carrier Compensation Regime, CC Docket No. 01-92, *Notice of Proposed Rulemaking* FCC 01-132 (rel. April 27, 2001).

positive incentives for carriers to invest in their infrastructures, diminish outmoded regulatory structures and accommodate technological and market forces.

Changing the methods and revenue flows associated with current intercarrier compensation schemes, whether as a result of market forces or as a result of FCC action, will bring about a dramatic redistribution of traffic revenues and shifts of cost recovery responsibilities among carriers, consumers, services and locations. This will result in widespread consequences, many of which will be positive, although major and unwelcome dislocations may occur due to the sheer size and reach of the financial impact of the change. Therefore, it is expected that any change will occur over time. The most important thing the FCC can do is to establish the policies necessary to accommodate technological and market forces in such a way that investment in the industry will thrive. The FCC must also establish equitable transition mechanisms that provide a clear signal of its objectives as well as sufficient notice of the changes that it intends to implement so that all service providers, manufacturers, investors, employees and customers know what to expect and have the same opportunity to prepare. USTA's comments will address the drivers for change, concerns that future policy must address, the pros and cons of bill and keep and the conditions that would be necessary to provide an equitable transition to bill and keep.²

11. ISSUES RAISED BY EXISTING INTERCARRIER COMPENSATION MECHANISMS.

A. Regulatory Arbitrage and Outdated Regulatory Distinctions Are Driving the Need to Reexamine Current Regulation.

In order to maintain a seamless flow of communications, networks must interconnect with other networks. Currently, a regulatory patchwork of mechanisms exists to compensate

certain carriers for the transport and termination of communications. Certain drivers are creating anomalies in the current systems that compel new FCC policies. These forces are causing regulated carriers to chafe as they rub against regulatory structures that no longer make sense given the changes in the industry. In some cases, they represent regulation created for an analog, circuit-switched environment that is evolving out of existence. In others, the drivers represent increasing market demand for new services and greater data communications capacity. The FCC must make the changes necessary to allow communications providers to react to these drivers in a manner that is efficient and that responds to customer needs.

As the NPRM explains, the current intercarrier compensation mechanisms are determined based on types of carriers, such as whether the carrier is a local exchange provider, an interexchange provider, a CMRS provider or an enhanced service provider; and on types of services, such as whether the service is classified as local, long distance, interstate, intrastate, intra- and interLATA, basic or enhanced. The FCC has promulgated interconnection rules based on these distinctions and the states have done so in the intrastate jurisdiction, although not always in concert with the Federal rules. The FCC's access charge rules govern compensation among local and interexchange carriers for the origination and termination of long distance services and its reciprocal compensation rules govern compensation among carriers for the transport and termination of local services. The FCC sets access charges for services deemed interstate and the state regulatory commissions set access charges for services deemed intrastate. Access charges also have different rate structures that do not always match the way the access service is provided. Technology is rendering these provider/service distinctions obsolete. The FCC has identified and correctly expressed its concern with regulatory arbitrage, which can be

² The United States Telecom Association (USTA) is the nation's oldest trade association for the local exchange carrier (LEC) industry. USTA represents more than 1,200 telecommunications companies worldwide that provide a

defined as exploitation of artificial profit making opportunities created by administrative rules rather than by market conditions. It is important to note that such regulatory arbitrage opportunities are created not only by current intercarrier compensation arrangements, but also by regulation asymmetrically applied to different carriers, technologies, service platforms and services. Rules that create artificial distinctions will create false signals to entrants and will provide uneconomic investment incentives.

The NPRM lists several current problems exacerbated by the existing interconnection regulations including various forms of regulatory arbitrage, terminating access monopolies, whether different types of networks require different interconnection rates, distortions in the structure and level of end user charges and distortions in an entity's subscription choices. Other arbitrage opportunities may exist as a result of interstate and intrastate distinctions that can provide incentives to distort usage measurements to reflect a more favorable regulatory environment.

Access charge arbitrage reflects the fact that interexchange carriers pay interstate and intrastate access charges to the LEC to cover the costs incurred by the LEC in providing originating, terminating and transport services associated with a toll call. An ISP that provides an information service, like Internet access, is exempt from the payment of access charges for the costs associated with the use of LEC facilities in the provision of Internet services. Thus, customers can avoid paying for their use of LEC facilities by using Internet telephony to place a long distance call. Recent developments in capital markets indicate that investors are becoming more sensitive to the difference between long-term economic opportunities and returns and those based on gaming regulatory structures. However, there remains a concern over inefficient

full array of voice, data and video services over wireline and wireless networks.

investment driven by artificial incentives created by regulatory distortions of market structure, cost, rates, services and market signals.

Some of the arbitrage issues listed in the NPRM are addressed in various transition plans that have been adopted by the FCC. For example, the FCC has approved the CALLS plan to lower access charges and increase subscriber line charges (SLCs) for price cap LECs, a plan to transition CLEC access charges to a benchmark rate equal to that of the ILEC, and a plan to reduce reciprocal compensation payments for ISP bound traffic. Currently pending before the Commission is the Multi Association Group (MAG) plan to lower access charges and increase SLCs for rate of return LECs over a five year period. For some carriers, the existence of these transition mechanisms lessens the urgency of moving to a new intercarrier compensation regime at least until the transition plans have been completed. Other carriers view these plans as insufficient to fully address their needs. As will be discussed below, there may be other forces that compel a more immediate response in some cases and not in others, depending upon market conditions and the availability of certain technology in particular areas. Timing and transition issues are critical and will require further analysis.

B. The Evolution of Technology and Market Demand are Also Drivers for Change.

The need to alter current regulatory structures is also being driven by changes in technology and the market. The policies for the future should recognize that different technology platforms will compete for customers and that future interconnection policy must apply to all technology platforms and networks in the same manner. The effects of any regulatory change of the size and scope contemplated in this proceeding can be better anticipated in the context of a full understanding of the technological and market environment within which the changes will occur. It is imperative for the Commission to recognize and analyze current trends in

technology, markets and business practices as they evolve. It is also critical for the FCC to recognize that the technological and market environment within which changes in intercarrier compensation decisions are made will also be substantially influenced by the resolution of other policy issues now under review and consideration.

The current compensation mechanisms were not designed to recover the costs required to provide the wide variety of services, platforms or bandwidth needs that will be demanded in the future. For data traffic alone, the traffic volumes are growing at rates ten to fifteen times faster than voice traffic. Most homes have the ability to access the Internet which is becoming the platform upon which convergence is occurring. By the year 2002, IP-based networks are projected to carry fifteen percent of the world's voice traffic and as many as five million subscribers in the U.S. will be placing a large percentage of these calls.³ As the industry migrates to fast packet technology, the switch itself could be decentralized into different components at different locations. New network services are not usage sensitive and may not require the systems that are part of the public switched telephone network. The definitions that characterized telecommunications services in the past are not relevant for carriers who do not have a local service area or who do not need to distinguish toll traffic. A minute will simply be a minute or will be characterized under a flat rate that will not even account for traffic on a per minute basis. For example, broadband service will not be sensitive to the same units of measurement as the present switched service models. The end user connection may be referred to as a pipe instead of a loop. The standard unit could be capacity driven as bandwidth or bits. New units of measurement will wreak havoc on current rate structures, and customer understanding.

³ Shannon Pleasant, *IP Services: Market Overview*, Cahners In-Stat Group, Feb. 2000 at 6-8.

This is now a multi-network, multi-provider, multi-service, digital and broadband based world that at both a business and operating level is indifferent to old labels such as LEC, ILEC, CLEC, IXC, CMRS, CATV, ESP, ISP and LATA. Billions of dollars are being invested as communications companies of all types position themselves to offer a wide array of services and consumers can use traditional voice telephony, wireless cellular, wireless spread spectrum, traditional satellite, low earth orbit satellite, cable, digital subscriber line (DSL), or the Internet to communicate. Technology has evolved from circuit-switched to packet-switched networks. As computer processor power continues to grow rapidly, as software becomes more sophisticated and as people adjust to using computer networking more and more in their daily lives, there will continue to be an increase in the demand for bandwidth. The advances in bandwidth combined with the innovations in networking technology make geographical limitations less relevant. Data traveling along a packet-switched network does not encounter arbitrary local/long distance borders and cannot be classified as voice, fax, text or video. On the Internet, data crosses freely across government jurisdictions, political boundaries, continental frontiers and cultural barriers. It is only in the regulatory arena that these old labels are used. Integrated digital service offerings, such as those provided over the Internet, present fundamental problems to a regulatory framework dependent upon technological distinctions. Rather than concentrate on managing wireline interconnection and compensation for analog services, the FCC must contemplate a new intercarrier compensation regime that does not rely on these old labels.

With all the traditional lines of business in the communications industry blurring, it is not surprising that the fastest growing technology platforms are those that are not subject to regulations that specify geographic boundaries, that separately define services and that require

specific pricing structures. They are platforms that deliver a bundle of digital services seamlessly with no distinctions, including voice, data, Internet access, video, music, and e-commerce. With these platforms, providers can price and package different bundles of services to accommodate different customer needs and to permit consumers to communicate anywhere in the country for a single nationwide rate.

The blurring of the legacy regulatory lines are anticipated most dramatically in IP Telephony. The Internet has become an integral part of the business and consumer environment. The Internet obliterates traditional service distinctions and definitions. Its pricing has evolved independently of regulatory constraints and it has the capacity to compete with the full array of service offerings from traditional networks. The prospect for growth of voice over Internet protocols (VOIP) is the most obvious driver of the future. The demand for broadband Internet access will require further expansion of the telecommunications environment. Internet service providers will continue to seek opportunities to increase revenue streams with the addition of new applications, thus further blurring the lines of different media. For example, Microsoft recently aired a television commercial in which a teenager, who has her telephone privileges taken away by her mother, jokes with a friend that her mother doesn't know she can have a voice conversation on her PC. Microsoft's new Window's XP operating system, scheduled to be commercially available on October 25, 2001, will include both high quality telephone and directory features.⁴ Microsoft will combine improved versions of current features such as online video meeting software and Internet voice chat into a more sophisticated version to be known as Passport. The company hopes to generate new subscription revenues and will offer Caller ID and voice mail as it begins to compete with traditional telecommunications companies.

⁴ John Markoff, *Microsoft is Ready to Supply a Phone In Every Computer*, The New York Times on the Web, June 12, 2001.

Microsoft could bundle telephone calling as a free feature of its operating system. Under current regulatory treatment, Microsoft is an ISP and is exempt from paying access charges if it uses the local telephone company network to complete a call. Microsoft is also exempt from contributing to universal service and bears no carrier of last resort responsibilities. AOL/Time Warner also has similar voice features, although it has not yet announced plans to improve or integrate those services. Revenue from Internet telephony is projected to grow over the next five years. Frost & Sullivan estimates that IP revenues will grow from about \$1.2 billion in 2000 to over \$66 billion in 2005.⁵ IDC estimates that IP revenues will grow from a little over \$1 billion in 2000 to roughly \$61 billion in 2005.⁶

There are other examples of companies searching for cheap ways to offer voice services over high-speed connections. Broadview Networks announced that it would begin offering voice over DSL service on July 30, 2001.⁷ Bundling voice and Internet services will increase competition with wireline companies and provide new options for consumers. Voice over DSL technology allows the bandwidth of a high speed Internet connection to be split into multiple virtual phone lines. Thus, a small business could have sufficient phone lines with sufficient bandwidth for Internet access for relatively low cost. AT&T has stated that it will use the DSL network it recently bought from Northpoint to offer voice services as it loses access to the cable network it originally bought for this purpose.

Wireless providers are continuing to build nationwide footprints, expand their digital offerings and develop innovative pricing plans.⁸ There are six nationwide mobile telephony

⁵ *World VoIP Services Update* #6369-61, Frost and Sullivan, 2001.

⁶ Elizabeth Farrand and Mark Winther, *IP Telephony Services: Market Forecast and Analysis 1999-2005*, International Data Corporation Report #23625, Dec. 2000.

⁷ *Voice-over-DSL Getting New Lease on Life*, CNET Networks Inc., July 24, 2001.

⁸ Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, *Sixth Report*, FCC 01-192 (rel. Jul. 17, 2001) [Sixth Report].

operators: AT&T Wireless, Sprint PCS, Verizon Wireless, VoiceStream Wireless, Cingular Wireless and Nextel.⁹ There are also a number of large regional companies, including Western Wireless, US Cellular, Dobson Communications and ALLTEL. At least two companies, AT&T Wireless and Nextel, are international and offer a pricing plan that allows customers to use their phones and the same phone number worldwide. By the end of 2000, the mobile telephony sector generated over \$52.5 billion in revenues, increased subscribership to 109.5 million and produced a nationwide penetration rate of 39 percent.¹⁰ Almost 91 percent of the total U.S. population have access to three or more different operators offering mobile telephone service in the counties in which they live. Since late 1999, seven major mobile telephone operators have begun offering mobile data services including wireless web, short messaging service and e-mail. Four of those seven reported 2.5 million mobile Internet users.¹¹ The cellular market continued to grow at double-digit rates in 2000 and the availability of digital cellular will continue to stimulate subscriber growth.

The Cellular Telecommunications and Internet Association estimates that five percent of mobile telephone users rely on their wireless phones as their only phones.¹² In some areas, wireless use has begun to erode wireline revenue due to technology substitution.¹³ AT&T blamed its second quarter 2001 \$149 million loss in part on customers switching from the traditional copper wire to wireless and Internet technologies to complete long distance calls.¹⁴ In a survey performed for the Consumer Electronics Association, three in ten wireless phone users stated they would rather give up their home telephone than their wireless phone. Among users aged 18

⁹ *Id.* at 13.

¹⁰ *Id.* at 5.

¹¹ *Id.*

¹² *Id.* at 32.

¹³ Andrew Backover, *AT&T Loss reflects Long-Distance Shift Consumers Turn to Calling Cards, Wireless*, USA Today, Jan. 30, 2001 at B3.

¹⁴ Christopher Stern, *Ailing AT&T Reports \$149 Million Loss*, The Washington Post, Jul. 24, 2001, E12.

to 34 years old, that figure rose to 45 percent.¹⁵ Sprint recently announced that new and existing Sprint PCS customers who sign up for Sprint long distance will receive fifty minutes of free home long distance each month.¹⁶ Twenty million mobile telephone customers have service plans that do not charge extra for long distance and one analyst believes that such plans are reducing wireline long distance minutes and revenues.¹⁷ Several wireless carriers have begun offering service plans designed to compete directly with wireline local telephone service. An example noted by the FCC in the Sixth Report is Leap, offering service in the south and southwest portions of the country. It allows subscribers to make unlimited local calls and receive calls from anywhere in the world for one flat rate of \$30 per month.¹⁸ The ability to offer innovative pricing plans has played a large role in the growth in subscribership for cellular services. Likewise, when AOL changed from usage sensitive rates to a flat charge for unlimited usage in late 1996, the number of customers and the usage per customer rose dramatically and other competitors soon followed. Many believe that the reason Internet penetration is lower in Europe than in the U.S. is because local service access to the Internet is priced on a traffic-sensitive basis.¹⁹

High speed data service over fixed wireless and satellite is emerging as well. Third generation CMRS service will soon reach consumers. Several U.S. mobile telephone carriers have announced their 3G rollout plans and at least six carriers expect to begin deploying network technologies in 2001 and early 2002 that will allow for mobile Internet access speeds of up to

¹⁵ *Sixth Report* at 32.

¹⁶ *Sprint Expands Sprint PCS Nationwide Long Distance to Include Free Home Long Distance Calling*, Sprint PCS Newswire, **Jul.** 9, 2001.

¹⁷ *Sixth Report* at 33.

¹⁸ *Id.*

¹⁹ Patrick DeGraba, *Bill and Keep at the Central Office as the Efficient Interconnection Regime*, FCC OPP Working Paper Series, Dec. 2000.

144 kbps.²⁰ The Commission recently awarded licenses to eight companies, including McCaw, Boeing, Globalstar and Iridium to provide mobile voice, data, Internet access and other new satellite communications services to all parts of the country, from urban areas to remote rural communities.²¹ Indeed, Japan's NTT DoCoMo was so bullish on the potential of 3G services that it invested nearly \$10 billion for a sixteen percent stake in AT&T Wireless.²²

According to the National Cable Telecommunications Association (NCTA), the number of new cable modem, cable telephony and digital video subscribers increased markedly during the third quarter of the year 2000.²³ Since launching high speed Web service in 1998, cable systems have signed up almost five million Internet customers.²⁴ Digital cable, with its widely expanded channel offerings has proved to be even more popular. In the past three years, the industry has signed up twelve million customers. With more than 96 million homes passed by cable, cable companies have a very significant potential base of subscribers for high-speed cable modems.²⁵ Cable companies have a substantial head start over the phone companies in providing broadband access to the home. This is crucial because consumers are not likely to switch technologies after purchasing and installing modems.²⁶ The number of cable modem subscribers is projected to increase from 2.6 million in 2000 to 10.8 million in 2004. Revenues are projected to grow from \$1.3 billion in 2000 to \$2.9 billion in 2004. Within the next year cable systems will be providing video on demand. This will allow customers to download movies and other programs without waiting for them to be scheduled. Speaking at the NARUC

²⁰ *Sixth Report* at 7.

²¹ *FCC International Bureau Authorizes New Mobile Satellite Service systems in the 2GHz Band*, FCC News Release, Jul. 17, 2001.

²² Peter S. Goodman, *DoCoMo in Translation*, The Washington Post, Dec. 1, 2000 at E1.

²³ National Cable Television Association, Press Release, November 13, 2000.

²⁴ Christopher Stern, *Cable's Lung Reach*, The Washington Post, July 15, 2001 at H1.

²⁵ 2001 MultiMedia Telecommunications Market Review and Forecast, Telecommunications Industry Association at 137.

²⁶ *Id.* 139-140.

convention last month, Robert Sachs, President and CEO of NCTA stated that cable television companies would be making great strides with VOIP services during the next five years.²⁷ Cable companies are now serving 1.3 million residential phone customers utilizing traditional circuit switched technology. Mr. Sachs noted that many cable companies see VOIP as a logical next step in local telephone competition, which he believes will be fully realized within the next five years, most likely from facilities-based cable broadband networks rather than through resale or UNEs.

It is likely that networks in the future will be all digital, broadband, “always on,” ubiquitous and intelligent.²⁸ In a recent Brookings Institution study, widespread deployment of broadband technology was estimated to have an economic benefit for U.S. consumers and producers of \$500 billion a year or more.²⁹ The study estimates that universal deployment of broadband services will result in subscription fees from computer or network equipment ranging from \$249 billion to \$389 billion annually. Economic benefits derived from shopping, entertainment, reduced commuting, telephone services and telemedicine will range from \$272 billion to \$520 billion annually. These estimates are predicated on regulatory and market conditions that do not currently exist and on broadband applications that do not exist or are not fully developed. However, in a period in which the U.S. economy remains flat, the potential influence of the communications industry on economic growth cannot be ignored. While the technological advancement that will make such networks possible will continue, the policies that

²⁷ Telecommunications Reports Daily, Jul. 17, 2001.

²⁸ Richard Adler, *Telecommunications – 2011*, The New Global Telecommunications Industry & Consumers, 2001 Update – Competition Moves Forward, Pennsylvania State University Institute for Information Policy, rel. June 2001.

²⁹ Robert W. Crandall and Charles L. Jackson, *The \$500 Billion Opportunity: The Potential Economic Benefit of Widespread Diffusion of Broadband Internet Access*, Brookings Institution, Jul. 16, 2001.

the FCC adopts in this proceeding will impact the speed by which they develop and which players are provided with the incentives to develop them.

The FCC is aware of these changes. There have been many papers released by the FCC in the past several years regarding the growth in the deployment of broadband services and Internet transport access that recognize that the challenges for the future come from the convergence of technologies and the expanding use of the Internet protocol for the delivery of services traditionally offered over legacy technologies.³⁰ In its *Notice of Inquiry* on Section 706 of the Telecommunications Act of 1996, the Commission acknowledged that its regulatory system was uneven in its treatment of different technologies and that statutes and rules containing separate regimes for wireline and wireless, local and long distance, telecommunications, broadcast, cable, etc., may distort the performance of the market.³¹

The recent General Accounting Office report to Congress also recognizes the need for a regulatory change in how services are regulated by the FCC.³² The GAO observed that “even with passage of the Telecommunications Act of 1996, communications law retains a ‘stovepiped’ – or compartmentalized – structure under which each traditional communications service is governed by particular laws...The capability of several networks to provide consumers with an identical service – physical transport to the Internet – has resulted in a regulatory

³⁰ Oxman, *The FCC and the Unregulation of the Internet*, Office of Plans and Policy, Federal Communications Commission, OPP Working Paper No. 31, rel. Jul. 19, 1999. See also, Kende, *The Digital Handshake: Connecting Internet Backbones*, OPP Working Paper No. 32, rel. Sept. 2000; Werbach, *Digital Tornado: The Internet and Telecommunications Policy*, OPP Working Paper No. 29, rel. Mar. 1997 and Esbin, *Internet Over Cable: Defining the Future in Terms of the Past*, OPP Working Paper No. 30, rel. Aug. 1998.

³¹ *Notice of Inquiry*, CC Docket No. 98-146 (rel. Aug. 7, 1998).

³² *Technological and Regulatory Factors Affecting Consumer Choice of Internet Providers*, Report to the Subcommittee on Anti-trust, Business Rights and Competition, Committee on the Judiciary, U.S. Senate (rel. Oct. 2000).

conundrum. Should the various communications providers be held to the same rules when providing the same service?”³³

Given the evolving technology, markets will be dramatically more competitive than in the past. Market rivalries will be far more widespread, intense, focused and involve more customer options. Market forces will be much more capable of serving the public interest than regulation. Several technology platforms will be available and will likely secure sufficient funding to provide expanding and intensifying competition in markets for local broadband telecommunications services. Despite current uncertainty in financial markets, investment in the industry should continue to grow and diversify, thereby compounding competition. Commission statistics and the business press document industry consolidation as well as the increasing financial size and strength of competitors. Competition may also be uneven, as new entrants will continue to target high margin markets.

New policies are needed. Policies for the future should not handicap particular technologies or providers. The FCC must determine if bill and keep is appropriate to address these forces.

C. Concerns Highlighted by the Changing Environment Should be Addressed by New FCC Policies Aimed Toward the Future.

The forces described above, regulatory arbitrage, technology and market demands, have also raised concerns as to how important issues can be addressed in a bill and keep compensation arrangement. The FCC must consider the consequences of shifting cost recovery responsibilities among carriers, consumers, services and locations. Appropriate recovery of costs is critical for carriers to maintain and increase infrastructure investment to meet market demand. Carriers that rely on revenues received from current compensation arrangements that could be displaced in the

³³ *Id.* at 7, 33.

future must have an equal opportunity to recover their costs from alternate sources. Given that end user recovery is contemplated under bill and keep, carriers that currently are subject to price regulation must have flexibility to implement capacity and package pricing similar to the pricing options described above. In areas where end user recovery would result in prices that are not affordable and reasonably comparable, universal service support will be required and the appropriate mechanisms must be in place. The current universal service support mechanisms will not provide sufficient support for high cost areas under bill and keep.

Rural carriers in the U.S. have relatively high loop costs because of the lack of economies of scale and density.³⁴ Compared to non-rural carriers, the customer base of rural carriers generally includes fewer high volume users. Rural carriers frequently have substantially fewer lines per switch than do non-rural carriers providing fewer customers to support high fixed network costs. Total investment in plant per loop and plant specific and operations expenses are substantially higher for rural carriers. Given these particular challenges, any new policies and mechanisms adopted by the FCC must accommodate the market and operational circumstances faced by telecommunications carriers serving high cost areas. Changes in universal service must occur contemporaneously with changes in compensation arrangements to ensure that the requirements of the Act are met and customers in high cost areas are served.

In addition, the FCC must address the fact that competition and technology develop in different ways at different times in different markets. For example, the growth of the Internet has been uneven. The top seven metropolitan areas host 62 percent of the nation's Internet backbone capacity and the top 21 metropolitan areas contain 87.5 percent of the nation's

³⁴ *The Rural Difference*, Rural Task Force White Paper 2, Jan. 2000.

backbone capacity.³⁵ Rural areas may not have the ability to host major Internet destination sites because those types of sites require tremendous amounts of bandwidth that may not exist in rural areas. While market forces will drive deployment, the FCC must continue its efforts to ensure that consumers in all regions of the nation have access to advanced telecommunications capability in a reasonable and timely fashion.³⁶

Timing of any change in compensation arrangements is critical to ensure that carriers maintain revenues necessary to serve their customers and attract new ones. As noted above, an equitable transition is required so that all carriers know the “end game” and have adequate notice so that they can prepare and avoid displacements. For example, rate of return companies have not implemented access reform measures and it is uncertain when the pending MAG plan will be adopted and what new requirements the FCC will include in the final plan. An appropriate, equitable transition must be adopted.

With new technologies driving the marketplace with a variety of platforms and new pricing structures, it is likely that new traffic consumption patterns may occur and there is concern regarding the ability to recover the costs necessary to change current network structures. Existing operations, maintenance, provisioning, billing, application services and customer access will undergo significant changes. For example, if LECs move to a flat rate price structure for toll service, it is likely that customer calling habits will change. There may be significant stimulation of the toll business that historically has been based on usage. With usage no longer the underlying principle for pricing and traffic consumption significantly increased, the costs to provide service could also increase significantly. The additional facilities needed to handle

³⁵ Robert Gibson, *Technology and Change*, The New Global Telecommunications Industry & Consumers 2001 Update – Competition Moves Forward, Penn State University Institute for Information Policy, June 2001.

³⁶ Deployment of Advanced Telecommunications Capability: Second Report, Federal Communications Commission, Aug. 2000.

increased toll traffic would be enormous. The magnitude of these changes in customer consumption patterns would be reflected in additional costs to address the need for additional network capacity build-out and supporting activities. New support systems, additional personnel with enhanced skills and comprehensive network planning models will be needed and all mediums must be considered. Quality of service concerns to ensure satisfactory and nondiscriminatory interconnection must be addressed.

Finally, for those ILECs currently under regulatory restraints, the FCC must reexamine traditional, legacy rules that may not make sense in the converged telecommunications environment of the future. As competition intensifies, efficiency gains from changing current compensation schemes will be diluted to the extent that regulatory handicapping and platform discrimination is not stripped everywhere from the FCC's rules. Efficiency gains from an economically rational compensation plan will be limited to the extent that other regulatory policies are not concurrently brought into line. It is neither advisable nor sustainable to continue to perpetuate the disparities in regulatory control of market conduct as they now exist between different technological platforms. Most of these differences are historical artifacts derived from dissimilar business origins and evolutionary paths. For example, with respect to cable providers, the FCC has adopted *voluntary* competitive carrier non-discriminatory access commitments for cable modem services, including data and Internet access. Conversely, the FCC regulates the ILECs' provision of DSL services for data and Internet access as telephone exchange or exchange access subject to the unbundling obligations of Section 251 of the Act. DSL services and cable modem services are functionally equivalent services provided by carriers that have historically been regulated under different provisions of the Communications Act of **1934**. FCC policies should treat functionally equivalent services the same, regardless of the provider.

111. THE APPROPRIATE OBJECTIVES OF A UNIFIED INTERCARRIER COMPENSATION POLICY

In order to ensure that the transition to a new intercarrier compensation policy is executed in an equitable manner, the FCC must be explicit regarding its objectives. It is important for all parties to have an opportunity to determine if the policy ultimately enacted satisfies the objectives for developing the policy in the first place. All parties must have the opportunity to prepare by taking the steps necessary to implement those changes. The following objectives are designed to address the external drivers discussed above that will require all industry participants to make choices in the future.

- *Minimize regulatory intervention:* Regulated carriers need flexibility to develop business plans to adapt to new policies and to address technology and market forces as well as an equal opportunity to recover costs. Regulatory arbitrage opportunities must be eliminated so that no participant can gain an advantage by gaming regulatory requirements. The need for regulatory intervention should also be minimal to avoid undermining individual parties' opportunities to bargain and to reduce regulatory costs.
- *Coordinate state and Federal policies:* The NPRM recognized the critical importance of balancing the responsibilities shared with state regulatory agencies. Successful and timely resolution of jurisdictional issues is critical to the success of any major change to the current compensation mechanisms. Achieving these objectives are contingent on consistent state actions, particularly with regard to the redistribution of cost recovery responsibility that will accompany bill and keep.
- *Ensure competitive neutrality:* No participants should be disadvantaged in addressing market forces because they have to absorb costs that are imposed by others, thereby affecting their ability to compete.
- *Ensure technological neutrality:* Any new policy should not advantage or disadvantage a particular technology and should permit the seamless transfer of information over interconnecting networks.
- *Maintain universal service:* Explicit, specific, predictable, sufficient and competitively neutral universal service mechanisms must be maintained contemporaneously with the implementation of any new compensation policies. All providers of any type of communications services using any technology should contribute to universal service.

- *Provide incentives for investment and innovation:* Cost recovery mechanisms should provide appropriate incentives and opportunities for carriers to invest in their network infrastructure throughout the Nation.
- *Ensure quality of service:* Interconnection responsibilities must be established and enforced in a nondiscriminatory manner to provide for seamless network transfers of information as well as to avoid inefficient investment decisions.

In general, any new intercarrier compensation policies adopted by the FCC should foster economic decision-making by carriers, manufacturers, investors and consumers that will encourage networks to interconnect and thereby facilitate universal service by providing seamless and ubiquitous networking at affordable prices. As households, businesses, schools, hospitals and other entities are connected to each other, the greater the value of the networks themselves. Intercarrier compensation policies should rely to the extent possible on market and technology forces and should be self-administering. Reliance on market and technology forces will avoid the current arbitrary, regulatory regime necessary for regulators to allocate costs. Any new policies should apply to all types of services, networks, and providers to avoid regulatory arbitrage opportunities and to encourage competitive neutrality. Regulatory intervention should only occur where such forces do not offer affordable options. If regulators are ultimately forced to intervene, prices should be set at a level that fosters the continued investment in network infrastructure. If prices are not affordable and reasonably comparable, universal service support must be available. Market-oriented policies along with targeted, explicit, sufficient, predictable and competitively neutral universal service support will be key elements in policies that make sense for the future.

IV. POLICY CONSIDERATIONS FOR A BILL AND KEEP REGIME

A. Some Pros and Cons of Bill and Keep

Converting from the current calling party's network pays (CPNP) regime to bill and keep could prove to be beneficial for the industry, although there could also be major and unwelcome dislocations due to the sheer size and scope of the change. Bill and keep represents a drastic change from the current CPNP system, but it does provide greater opportunities to achieve economic efficiency. While the current system relieves the called party from sharing in most of the costs of communications, it is true that the called party has made an economic decision to be on a network and to receive calls. Under bill and keep, the called party would share in the costs of that decision. Bill and keep reflects principles of cost causation and is consistent with the FCC's policy to reflect that principle by moving a greater responsibility for cost recovery to the end user customer. This will be beneficial in two ways. First, consumers will be encouraged to make better choices if they bear the direct economic impact of those decisions rather than having the impact spread to other customers through pricing plans of other carriers, a characteristic of the CPNP system. Second, if carriers must recover costs from end user customers rather than other carriers, bill and keep may encourage carriers to compete for those customers thus encouraging carriers to strengthen retail relationships, bringing more of the benefits of competition directly to customers.

Bill and keep also will encourage reliance on market-oriented solutions rather than regulation. It should eliminate the regulatory intervention required to estimate interconnection costs as well as any artificial usage-based costs that are incurred due to regulatory requirements. By replacing carrier access charges with end user recovery, bill and keep eliminates the access charge arbitrage issue. By replacing terminating charges with end user recovery, the reciprocal

compensation and terminating access monopoly problems are eliminated. Bill and keep could also allow LECs to manage the erosion of access charge revenues that may result due to competition and technology. It would minimize speculation as to any alleged anti-competitive price squeeze since carriers would not have the opportunity to leverage access prices to keep competitors out of the market. The elimination of regulatory arbitrage encourages efficient investment since market signals are permitted to govern behavior rather than administrative rules.

However, the FCC should also consider the issue surrounding terminating access monopolies in a broader context. The FCC has yet to recognize the competitive opportunities presented by other networks and technologies and appears to be utilizing a narrow interpretation of a terminating access monopoly as justification for maintaining some regulation instead of relying on market forces. According to the NPRM, a terminating carrier has a monopoly over the traffic delivered to end users because interconnecting carriers must use the terminating carrier selected by that end user. USTA disagrees with that viewpoint. **So** long as the customer has a choice of carriers to terminate traffic, there is no monopoly. A monopoly would only exist if the customer did not have a choice of carrier. Individual customers who choose a particular carrier over another carrier do not establish a monopoly relationship as to the chosen carrier. If a monopoly could be established on an individual terminating carrier, carriers would never be able to escape regulation. Bill and keep would appear to address the FCC's concerns in this regard.

There also may be detrimental consequences from the adoption of bill and keep, some that can be anticipated and some that are unknown and cannot be anticipated. These consequences will be particularly acute if current access revenue streams are displaced and must be recovered from end user customers. This will create serious concerns regarding the

affordability of rates and the ability to maintain end user rates that are reasonably comparable between urban and rural areas. In addition, current access revenue streams are used to invest in the infrastructure and to provide new and advanced services. The incentives to make such investments must be preserved and increased.

The amount of cost recovery shifted to end user customers under bill and keep will vary by company. Ideally, reductions in access charges would be accompanied by reductions in toll charges for toll end user customers thus creating overall decreases for some end user customers in their communications bill. While shifting recovery of LEC costs to end users will obviously have impacts on the customer bill, there will be circumstances where the impact is severe. USTA has analyzed the impact of COBAK on rate of return LECs using data provided by NECA showing the possible impact on end users if intrastate and interstate switched access – including common line, local switching and fifty percent of dedicated transport – is recovered from end users instead of carriers. Based on a sample of 287 study areas, the intrastate impact of implementing COBAK ranges from a minimum of \$0.12 per line per month for certain companies with over 50,000 access lines to a maximum of \$88.05 per line per month for certain companies with between 1,000 and 2,500 access lines. The interstate impact of COBAK was estimated based on a sample of 1,241 study areas. Using the current SLC caps, the interstate impact of COBAK ranges from a low of \$7.70 per line per month for certain companies with over 50,000 access lines to a high of \$46.10 per line per month for certain companies with less than 500 access lines. The interstate impact of COBAK using the maximum SLC caps as approved in the CALLS plan and proposed in the MAG plan range from a low of \$4.66 per line per month for certain companies with over 50,000 access lines to a high of \$43.07 per line per month for certain companies with less than 500 access lines. The interstate impact of COBAK if

the MAG plan is adopted with the **RAS** and the maximum SLC caps range from a low of **\$2.47** per line per month for certain companies with over 50,000 access lines to a high of \$21.92 per line per month for companies with under 500 lines.³⁷ The current universal service mechanisms are not designed to accommodate these impacts, both in terms of the sufficiency of support and in terms of maintaining equitable contributions. The changing nature of retail relationships that may accompany bill and keep may require changes to the current universal service contribution determinations to ensure that they remain competitively neutral and all technologies contribute to the preservation of universal service.

The NPRM includes discussion of two possible bill and keep default approaches that would apply to all types of interconnection. Both COBAK and BASICS are designed to rely on negotiations among interconnecting networks but differ in the default provisions that would be triggered should negotiations fail. Both raise important issues that would have to be resolved before either could be implemented in a reasonable manner.

The default provisions of **BASICS** would split the costs incremental to interconnection equally among carriers and all remaining costs would be recovered from each carrier's own end user customers. Carriers would bid on the right to provide transport to another network. This approach would be difficult to implement and administer, as the default provisions are not clearly defined. Identifying and agreeing on the incremental costs of interconnection would be problematic and would require regulatory intervention. Such costs would be even more difficult to discern if a carrier wanted to interconnect at multiple points instead of one or if multiple carriers were involved in transporting a call. The bidding process itself would require a new

³⁷ The interstate impact figures are based on averaged rates for each size category. Several carriers would have impacts greatly in excess of these averaged rates. For example, the interstate impact of COBAK could be over \$1,000. per line per month under the MAG plan with the highest SLC levels, but without the RAS and over \$400.00 per line per month under the MAG plan at the highest SLC levels and with the RAS.

regulatory structure, particularly if the incumbent LEC was the only bidding party, a likely outcome in most rural areas. The fact that UNEs currently are priced at TELRIC may provide an advantage for certain carriers in the bidding process. ILECs already have a ubiquitous network in place to satisfy carrier of last resort responsibilities. If the ILEC loses the bid for transport, its customers probably would be responsible for the costs of stranded investment put in place to make sure that all consumers have an opportunity to receive service if no other carrier will serve them.

Under the default provisions of COBAK, a called party's carrier cannot charge an interconnecting carrier to terminate a call. Each carrier recovers the cost of the loop and local switch from its own end user customers. The calling party's network is responsible for the cost of transporting a call between the calling party's central office and the called party's central office. Establishing the central office as the point of interconnection (POI) raises many concerns, since carriers may locate their switches great distances from where the call actually terminates. Originating carriers could incur substantial costs to transport traffic to a terminating carrier switch, even in cases where the call is terminated in the building next door to where it originated. BASICS may reduce that problem to some degree since its default requires that transport costs be shared equally. In addition, large customers, especially those with large quantities of incoming traffic, may try to masquerade as carriers to reduce their transport costs since the originating carrier must absorb the costs to transport the traffic to them. Conversely, a carrier may try to masquerade as a customer if it is more economical under COBAK to do so. These opportunities for gaming merit additional consideration.

The NPRM requests comment on whether bill and keep will resolve the current problems it identifies and associates with the current CPNP regime. The resolution of the POI issue is

critical in assessing whether a bill and keep regime can successfully alleviate current interconnection problems and serve as the intercarrier compensation regime in the future.

B. A Framework for a Reasonable Bill and Keep Regime

As the NPRM suggests, a reasonable bill and keep regime designed to fulfill the objectives listed above may address many of the problems associated with the current CPNP regime and may permit carriers to address the drivers discussed above so long as certain conditions are met. The conditions that must be present to adopt bill and keep are as follows:

- Transitional equity. Carriers who have designed their business plans based on a specific set of assumptions inherent to CPNP regarding compensation arrangements, costs, rates and investment determinants must have the opportunity to adapt to a different set of assumptions under a new regime. While some participants would enjoy immediate benefits from bill and keep, others would suffer harms. Carriers must have an opportunity to identify and design the means to offset any harms that will have to be borne in order to participate in and benefit from a bill and keep regime. While some of the harms may be unavoidable by Commission action, many or most may be avoided or mitigated by companion policy changes.
- Universal Service. In areas where end user customer prices are not affordable and reasonably comparable, targeted, specific, explicit, predictable, sufficient and competitively neutral universal service mechanisms must be in place.
- Pricing Flexibility. All carriers should have the same ability to offer pricing options to their customers, including but not limited to, capacity-based pricing plans, package pricing, etc.
- Application to all carriers, networks and technologies. Convergence eliminates the need to have different rules for different carriers, networks and technologies. Seamless transfers of communications can only be assured if treated in the same manner. One of the FCC's goals must be to eliminate the arbitrage opportunities that characterize the current intercarrier compensation regime. Arbitrage borne of asymmetrical regulation dilutes market forces thereby threatening economic efficiency.
- Application to both the intrastate and interstate jurisdiction. Traditional jurisdictional boundaries are not relevant to current networks that have no geographic limitations and may not be relevant to any networks in the future. Unless implemented simultaneously in both jurisdictions, arbitrage opportunities will negate some of the benefits of bill and keep.

- Development of a reasonable bill and keep process. Such a process must meet the objectives outlined above and provide all parties with the opportunity to minimize collateral harms. A framework for a reasonable bill and keep arrangement is discussed below.

These necessary conditions can be incorporated into a policy framework for bill and keep under which the details of the regime can then be determined. The policy must reflect a preference for as well as appropriate incentives to facilitate negotiations among carriers and a reduced reliance on regulation. The bill and keep process must be accompanied by the rebalancing of current price structures as for example in the current transitions plans under which carrier access charges are replaced by increased end user rates and/or universal service. Universal service support is required in areas where prices under bill and keep are not affordable and reasonably comparable. Carriers should have pricing flexibility to implement capacity-based pricing plans, package pricing and any other plan that meets customer needs. Carriers should also have the flexibility to consolidate pricing of network access with local service pricing.

The bill and keep policy itself should apply to all carriers, networks and technologies for the interconnection of switched services, including interstate switched access, intrastate switched access, reciprocal compensation, intracompany settlements, wireless and paging. It should exclude specialized or ancillary network arrangements, such as special access, 800 database, LIDB, directory assistance and operator services. Each network access provider should be permitted to recover network access cost from its end user or universal service. Network access providers should negotiate network to network arrangements if necessary to interconnect their respective networks on a nondiscriminatory basis. If negotiations fail, default rules would apply so that the calling party's network access provider is responsible for the network to network transport to reach the POI serving the called party.

If the originating carrier must transport the traffic long distances, the costs of the originating carrier borne by its end user customer will increase. In cases where the amount and distribution of traffic is fairly balanced, the carriers will have a greater incentive to negotiate a mutually agreeable POI. In other cases, carriers may have incentives to minimize costs by attempting to force the other carrier to bear the majority of the transport costs. There must, therefore be a geographic limit on the network access provider's obligation to reach the POI that considers network efficiency, technical feasibility, customer density, and size of serving areas. Transitional POIs may have to be developed at the outset.

Network access providers with transport obligations should be free to build their own facilities or to lease facilities from a wholesale provider or from the called party's network access provider. But, network access providers should not be required to provide transiting services or to otherwise act as a wholesale provider without reasonable compensation. Network access should be consistently priced such that the destination of the call does not drive the price level or structure. Quality of service issues may have to be determined to define a network provider's responsibility to carry traffic and to define reasonable interconnection parameters.

In order to implement such a policy framework, specific processes must be established to address the following:

- Simultaneous implementation at both the state and federal level to avoid arbitrage opportunities and to ensure that policies are integrated;
- operational issues such as for example, equal access obligations, dialing parity, repair and maintenance obligations, billing issues, and network compatibility;
- timing of implementation; and,
- universal service mechanisms to address affordability and reasonable comparability.

The NPRM requests comment on whether bill and keep is appropriate for specific kinds of traffic, including ISP bound traffic, local traffic, access charges, CMRS traffic and paging. As noted above, the FCC should establish a specific process to examine and address timing of implementation. The FCC has already proposed to adopt bill and keep for ISP bound traffic at the end of the three year transition period. While the application of the current reciprocal compensation rules created gaming opportunities that the FCC had to address, it is not clear what impact, if any, moving ahead with bill and keep for ISP bound traffic on a different timeframe will have on the market.

As explained earlier, the dislocations associated with recovery of the costs incurred to provide access services from end user customers are particularly acute. Small LECs receive a significant percentage of their total revenues from access charges. The current system of interstate access charges achieves the historic policy objectives of both low intrastate local rates and low toll rates on a nationwide basis. LECs currently charge interexchange carriers for the costs the LEC incurs in originating, terminating and transporting interexchange calls. The recovery of these costs from interstate services serve to reimburse a significant portion of the costs borne by LECs which in turn allows the LECs to maintain local rates at affordable levels. The current structure also averages rates to ensure that even customers whose unit costs are above average remain on the public switched telephone network. Shifting a major portion of this cost responsibility from toll service under a bill and keep regime will eliminate a nationwide source of revenue from interstate users to help pay for universal services. At the same time, however, the current access structure does not work when certain carriers and services are allowed to utilize existing local networks and are not charged the same as interexchange carriers. Another issue arises from the fact that the current timeframe for access charge reform for price

cap LECs, CLECs and rate of return LECs is different. The latter has not yet been adopted. It is unclear whether the different timeframes can or should be maintained.

Bill and keep, if adopted based on the necessary conditions listed above, should apply to both CMRS and paging traffic. Currently, there are serious problems with the FCC's interpretation of the reciprocal compensation rules as applied to wireless networks that must be resolved. In a May 9 letter, the Common Carrier and Wireless Bureaus established a much broader definition of "additional costs" for wireless networks than the FCC previously established for wireline networks.³⁸ CMRS providers are not entitled to receive additional reciprocal compensation for network components that are functionally equivalent to a wireline carrier's loop when they are used to terminate traffic to mobile customers that originate on other carriers' networks.³⁹ Bill and keep may provide a solution, but the same rules should apply to all carriers and all networks to avoid uneconomic arbitrage and unfair competitive advantage. An easier case may be made for the implementation of bill and keep for all identifiably one way traffic, such as paging.

V. REFORMING THE CPNP REGIME SHOULD NOT MAKE IT WORSE

A. TELRIC is Not Appropriate to Set Access Charge Rate Levels

The NPRM contains several proposals for reforming the CPNP that would really only serve to make it a less functional compensation regime. For example, in addressing rate level issues the NPRM proposes that TELRIC be used to set the prices for both access charges and reciprocal compensation as an alternative to bill and keep and even suggests that this be adopted by the states for intrastate access as well. This proposal should be rejected.

³⁸ Letter from Thomas J. Sugrue, Chief, Wireless Telecommunications Bureau and Dorothy T. Attwood, Chief, Common Carrier Bureau to Charles McKee, Senior Attorney, Sprint PCS, CC Docket Nos. 95-185 and 96-98 and WT Docket No. 97-207, May 9, 2001.

The use of TELRIC to determine access charges and reciprocal compensation would eliminate incentives to be efficient, to upgrade networks, to provide advanced services and to invest in new technologies. It would not ensure that LECs are able to fully recover the costs of providing access services and could, therefore, discourage competition. Further, the use of TELRIC for access charges and reciprocal compensation would require the FCC to retain all of the regulatory cost identification and allocation rules that have proved to be vastly inefficient and to extend them to LECs that previously were not subject to such requirements. TELRIC is not appropriate for access charges and reciprocal compensation and its use to determine such prices will clearly result in worsening the inefficiencies of the current CPNP regime.

Likewise, short run incremental cost is inappropriate and would only exacerbate current pricing anomalies and arbitrage opportunities because it has the potential to create significant variations in costs that will require increased regulatory oversight to track. The FCC should exercise some self-restraint in its consideration of proposals that are so clearly worse than status quo.

B. New Rate Structure Requirements Should Also be Rejected.

The FCC has already addressed the issue of whether new rate structures under the current CPNP regime should be required and the response was resoundingly negative.⁴⁰ The current rate structure regulations should be simplified and/or eliminated, not replaced with new regulation. Carriers should have flexibility to use a capacity-based or other rate structure if reasonable, but the FCC should refrain from mandating such a rate structure. The current rate structure was

³⁹ Reciprocal Compensation for CMRS Providers, CC Docket Nos. 95-185 and 96-98 and WT Docket No. 97-207, USTA Comments filed June 1, 2000.

⁴⁰ Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers, CC Docket Nos. 96-262, 94-1 and CCB/CPD File No. 98-63, Comments of USTA filed Oct. 29, 1999 and Reply Comments filed Nov. 29, 1999.

initially based on the investment cost of switches plus expense divided by total minutes. This is an economically sound methodology to measure and recover traffic-sensitive costs and to ensure that there is no under or over recovery.⁴¹ It would be a mistake to mandate a capacity-based rate structure in the current regime because the implementation costs would certainly outweigh any potential gains. The information requirements and the associated regulatory oversight would be significant as individual carrier peak demands and all other peak demands of the particular switch would have to be determined. Carriers should have the ability to respond to market forces.

C. The Current Use of Virtual NXX Codes Should Not be Permitted.

The use of virtual NXX codes creates a cost recovery anomaly because of the assignment of a telephone number in an NXX to a customer who is not physically located in the exchange to which the NXX is assigned or who does not subscribe to the use of facilities physically located in that exchange. Nonetheless, the traffic is rated as local. Thus, the customer avoids paying toll charges, the carrier using the virtual NXX avoids transport or access charges and the originating LEC must pay the carrier reciprocal compensation. The originating LEC must assume all the costs of calls using virtual NXX. Virtual NXX also misuses scarce numbering resources by assigning an NXX to a rate center for customers that are not located in the rate center. The current numbering system is built around rate centers that distinguish between local and toll calls. Currently, with the exception of traffic to or from a CMRS network, state commissions have the authority to determine what geographic areas should be considered 'local' for the purpose of applying reciprocal compensation obligations under Section 251(b)(5), consistent with the state commissions' historical practice of defining local service areas for wireline LECs.

⁴¹ See, Comments of William E. Taylor, Ph.D., on behalf of USTA, Oct. 29, 1999.

Traffic originating or terminating outside of the applicable local area would be subject to interstate and intrastate access charges.⁴² Virtual NXX calls do not meet this criteria. A virtual NXX has the effect of changing the local calling areas of the originating LEC because the call is rated as local, even though the called party is outside the local calling area established by the state commission. This would occur without providing the state commission an opportunity to ensure compliance with any requirements and without regard for the impact on competition, rate levels or customer interests.

Virtual NXX is also contrary to the national numbering policy. The Commission has stated that carriers must provide, as part of their applications for initial numbering resources, evidence demonstrating that they are licensed and/or certified to provide service in the area in which they seek numbering resources. Carriers requesting initial numbering resources must also provide the NANPA appropriate evidence that its facilities are in place or will be in place to provide service within sixty days of the numbering resources activation date. The burden is on the carrier to demonstrate that it is both authorized and prepared to provide service before receiving initial numbering resources.⁴³

A change in the current numbering system to permit virtual NXX could create rate shock for customers if the current distinctions between local and toll calls are ignored or if local calling areas are altered. This misuse of numbering resources to provide service to customers who do not physically maintain a presence in the rate center should not be permitted under CPNP unless the carrier using the virtual NXX pays for the transport from the rate center to the customer as

⁴² Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, *First Report and Order*, 11 FCC Rcd 15499 (rel. Aug. 8, 1996) at ¶ 1035.

⁴³ Number Resource Optimization, *Report and Order and Further Notice of Proposed Rulemaking*, at ¶ 97.


well as any other appropriate compensation and the integrity of numbering resources is preserved.

VI. CONCLUSION

Understanding the environment within which regulatory changes in intercarrier compensation will be converted into market signals for consumers, investment incentives for managers, financial incentives for investors and business decisions for network operators is necessary if the FCC is to avoid unintended or unacceptable consequences. This is a tall order given the technological and economic dynamism that characterizes the current market and has made the status quo regulatory regimes unworkable. The framework provided herein may alleviate concerns regarding unwelcome consequences of a new system.

Respectfully submitted,

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August 21, 2001

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